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## NEWER TENDENCIES IN AMERICAN TAXATION<sup>1</sup>

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If we regard our fiscal development in the light of what is taking place abroad at present and what has occurred in the past, we have to signalize several marked tendencies now visible in the United States.

The first point is the relation between personal taxes and real or specific taxes, or, as our legal brethren say, between taxes *in personam* and taxes *in rem*. All taxes are ultimately paid by some person, but the tax may be in the first instance imposed upon a specific thing, irrespective of the person. A tax upon a man's entire income or entire property, intangible as well as tangible, is a personal tax. A tax upon a particular piece of property or upon a particular business which affords a revenue is a real tax or a specific tax or a tax on the thing apart from the person. It is significant that taxation has generally begun as a specific or real tax and that it developed into a personal tax. In New England, for instance, the earliest taxes were on particular things, like sheep and cows and houses and stock in trade; and only at a much later period do we find the general property tax, where the tax is imposed upon the individual with respect to his entire property, whether that property consists in things or in simple relations. For one reason or another, however, which it is not necessary to emphasize here, this personal tax everywhere turned out to be a failure; and step by step during the nineteenth century in Europe and more recently in some of our advanced American commonwealths the personal tax is again giving way to the real tax, the tax on things, the specific tax. So in France, it will be remembered, when the personal taxes were abolished in the revolution they were replaced during the whole of the nineteenth century by the specific taxes, a tax on land, a tax

<sup>1</sup> This introduction is adapted with a few slight changes from the presidential address of Prof. Seligman at the conference of the International Tax Association at Denver, September, 1914. Although it appears in the annual volume of the Proceedings of that Association, it is reprinted here because it is in itself so valuable and because it makes such a pertinent and suggestive introduction to the other papers in this volume.—The Editor.

on houses, a tax on business, a tax on doors and windows, a tax on movable capital. In the same way in the state of New York, the real estate tax has become a tax on property, irrespective of who owns it; the tax on mortgages is similarly a specific tax; the tax on secured debts is of the same nature; the bank tax is a tax on banks, not on the shareholders, etc. In Pennsylvania and other states, the business taxes under various names are taxes on things and not on persons. The excise tax in many of our states is a tax on things and not on persons. And even the inheritance tax is in part at least a tax on the thing, the estate, rather than, as in a few cases, a tax on the recipient of the individual share of the estate.

On the other hand, side by side with this undoubted tendency to replace personal taxes by real taxes or specific taxes, we find the tendency ever springing up anew to reintroduce in perhaps another way the system of personal responsibility through personal taxes. Take, for instance, the development of the income tax movement in this country; take the recent passage only a few weeks ago of the supplementary income tax in France; take the similar movement in every other part of the world. There is thus a double movement, a movement from personal to real or specific taxes, which is best illustrated in the process that is now going on in our state and local taxation, and a counter movement from real to personal taxation, which is also obvious in this country. The lesson to be drawn from these double tendencies we shall emphasize a little later on.

The second tendency is the development from local to general taxation. All taxes were originally local and only slowly did they become general or state taxes. Often when this happened, the state taxes were tacked on to the local taxes, as is still the case in most of the American commonwealths. It is only very gradually that we find a transition from local administration to general or state administration. We are in the midst of this development at the present time in the United States, a first stage in many of our commonwealths being the central control over the local administration, and only a few of our states having reached the point, which all will reach sooner or later, of a central administration, as in the case of the excise tax or the inheritance taxes in New York, of the income tax in Wisconsin and of the corporation taxes in several states.

Side by side with this development, however, or rather somewhat

subsequent to this transition from local to general taxation, comes the reverse movement from the general to the local tax. By this I mean the transition, not so much in the administration, as in the proceeds of the tax. Thus, as we all know, the specific taxes or real taxes in Germany, like the land tax, the business tax, etc., were relegated at the close of the nineteenth century to the local divisions, while the new personal tax, like the income tax, was kept for state purposes. The same is more or less true in England. And when we come to analyze it we find that this is the real meaning of the movement now in progress in this country, of the separation of state and local revenue, or of the segregation of source, a movement based on the idea that certain taxes are more properly general or state in character while others are more properly local in character, even though the administration of these local taxes may be profitably subjected to a central control. Just as no one can understand our present American development without grasping the distinction between taxes on things or real or specific taxes and taxes on persons, so no one can comprehend the real significance of tax reform in the United States today without bearing in mind this turn from general to local taxation and back again to the separation of state and local revenue.

The third tendency is the movement from property as the basis of taxation to the produce or yield of the property or to the income derived from the property. The reason why a general property tax has broken down all over the United States is not only because it was a tax on the person without the adequate machinery to assess the person, not only because it was an attempt to tax locally what is no longer local in character, but also because under modern conditions property as a whole is not so satisfactory an indication of tax-paying ability as the yield of the property or the income from the property. We see the truth of this statement in our corporation taxes, where the tendency is strong to tax receipts, that is, yield, rather than property. We see it in the agitation over our forest taxes and our mining taxes, where the tax on yield or produce is gradually supplanting the tax on property. We see it in the feeling on the part of our business men that the property invested in the business is not so satisfactory an index of fiscal obligation as the yield or the income. And that, of course, is the main reason why the twentieth century has become the century of income taxes rather

than of property taxes. It is this fact more than anything else which explains the gradual break-up of our general property tax.

On the other hand, we find a reverse tendency, precisely as in the preceding cases. In the case of the tax on land, especially for local purposes, property is a better index of fiscal obligation than the yield or the rent of the land, simply for the reason of speculation in urban land. The speculative property value of a piece of land may be far greater than the capitalized amount of the actual rent or rental value. Just as we are only beginning to catch up with Europe in a recognition of the fact that yield or income is a better test than property in general, so Europe is only beginning to catch up with us in recognizing the fact that for local land taxes property or selling value is a better test than rent or rental value. A large part of the explanation of what is going on in England and on the continent today in local taxation is explained by this desire to change from rental-value taxation to property-value taxation. A great part of the explanation of what is going on in this country today is a recognition of the transition from property or selling value to yield or income in taxes in general.

The fourth tendency is the transition from the older theory of benefits in taxation to the newer theory of faculty or ability. This is somewhat in line with the transition from the real taxes to the personal tax. The tax was imposed upon things because the particular thing was supposed to derive some benefit from governmental activity. The tax is nowadays imposed upon the person because the person is recognized as owing an obligation to support the state just as he is held to support his family. Yet here again there is a reverse movement, in part at least. We hear a great deal in modern times of privilege and the demand that privilege should be the real test of taxation. If by privilege is meant the benefit accruing to the thing or the individual, it is an illegitimate reversal to the primitive doctrine. If, however, the privilege be regarded as increasing the yield of the property or the income of the individual, the privilege may be rightly considered as enhancing the faculty or the ability of the individual to pay; and it is proper, therefore, that the ability derived from special privileges should be subject to special taxes.

Finally we notice the tendency in taxation away from individual to social considerations. This is responsible for the idea of progression or graduation in our income taxes; it is responsible for

the differentiation or distinction between earned and unearned incomes, as we find it abroad and shall probably soon find it here. It is responsible for the exemptions granted for general social reasons. By this we do not refer so much to the exemptions in the income tax as, for instance, to the exemption of mortgages from taxation in our property tax, or the exemption of money and credits. Again, to this cause we must refer the modern movement for a higher tax on land, especially in local finance. I am, indeed, not a single-taxer—far from it—for the single-tax philosophy makes two fundamental mistakes. It neglects the distinction, referred to above, between real or specific taxes and personal taxes. When the single-taxer says that land alone should be taxed, he is thinking only of things. But as I was careful to point out above, this distinction does not apply at all to the entire class of taxes on persons. The income of an individual may be derived not from things or property but from relations, from salaries, from good will, from copyrights, from all sorts of intangible and invisible circumstances. The distinction between land and other things does not affect in the least the obligation of the person to contribute to the support of government for income derived not from things. In the second place, the single-taxers either revert to the long outworn idea of benefits, or inordinately exaggerate the element of privilege in the conception of faculty. They erect into a whole what is only a small part.

While, therefore, I must consider the single-tax philosophy as essentially incomplete, it is none the less true that a higher taxation of land or rather, if you will—in order to differentiate my idea from that of exempting improvements in the local real estate tax, in which I do not believe—it is none the less true that an additional tax on land may be entirely legitimate from the social, rather than from the individual, point of view. And, finally, as I have often pointed out, certain indirect taxes which cannot be upheld at all from the point of view either of benefits or of faculty in taxation become perfectly explicable when we regard them from the social, rather than the individual, point of view, *i.e.*, from the point of view of their consequences on the body economic rather than from that of the relation of one individual to another.

What lessons, then, applicable to practicable tax reform in the United States are to be drawn from these world-wide tendencies in

fiscal theory and fiscal practice? To the attentive student these practical lessons are obvious.

First and foremost, I should put the administrative lesson involving the transition from local to general control. This is one of the most difficult lessons for Americans to learn, because of the inveterate habits of local self-government and the old slogan of home rule. That there is a certain justification for the home rule movement in general politics I do not wish to deny; but no one who has attentively studied the progress of good government the world over can ignore the fact that a certain degree of centralization is essential to progress. I agree with careful students of the problem, like Sidney Webb in England, that what they call the local administrative anarchy of the United States is just as bad as the other extreme of the centralized autocracy of some of the European countries, and that the real solution of the problem is not centralization but central control of local action. England, the classic home of local self-government, has made during the past few decades longer steps in central control than perhaps any other country. Without tracing the movement toward centralized state or federal control, which has become so marked in this country in the past few years, in our financial system, our school system, our sanitary system, our police system, etc., it is obvious that in fiscal matters those states now stand at the head which have developed an efficient central control over local action. The sooner all of our American states fall into line with the more advanced commonwealths and develop a centralized control over local revenues and local accounts, the greater the progress toward efficiency and justice. This, I should say, is the first great lesson for all of our local statesmen to learn.

But we have a still more important and a more difficult lesson to learn, the lesson, namely, that just as local finance must in some respects be subject to state control, so state finance must gradually be subject in some respects to central control. There is, indeed, such a control now, for no state can through its fiscal laws interfere with interstate commerce. But what I mean goes further than that. Just as our new federal reserve board is effectively to control the operation of banks within the states, just as our new trade commission is designed to control business carried on under certain conditions in the states, just as the demand for a national child labor law and for similar industrial legislation is becoming louder

and louder, so the time is fast approaching when it will be impossible as well as unwise to escape federal control of certain taxes, essentially interstate in character. In modern times corporate activity has transcended state bounds; incomes are derived from nation-wide sources; and the interstate complications connected with inheritances are becoming well nigh unbearable. It will be well for all our state officials to consider carefully how best to adjust the state taxation of corporations, inheritances, and incomes to these newer conditions. It may even be the solution that we shall gradually permit the federal government to administer these taxes and to apportion the proceeds in whole or in part among the various states according to carefully defined rules. The movement from local to state control and from state to federal control in certain points of our fiscal practice is one that we must all be ready to face and carefully to study.

The second lesson that I should like to emphasize is the tendency toward the separation of state and local revenue through the principle of segregation of source. Practically, of course, this means that the real estate tax should be reserved primarily for local purposes and that the state should be alimented by proceeds of state-wide activities or phenomena, such as corporations, inheritances, and the like. That the separation of local and state revenues is a panacea for all ills no one would affirm. Nor must we forget that there are in this movement difficult problems to be solved, as we have already seen in the case of California, New York, Connecticut, etc. But the chief problems, namely, the question of providing local revenues on the one hand, and of insuring an elasticity in the state revenues on the other, are by no means insoluble, and the immense advantages that would accrue from a reasonable separation need not be adverted to here. One word only of caution. Do not confuse the segregation of the sources of local revenue with local option. While a certain degree of freedom ought within bounds indeed to be granted to the localities, it is essential, as I have intimated above, not to sacrifice the general scheme of central control to the risk of what has been called local anarchy. Just as the federal government does not permit any state fiscal interference with interstate commerce, so the state cannot permit any local disruption of the conditions that make for state-wide economic prosperity. The movement toward extreme local option, in fiscal policies at least, is like the movement to an



exaggerated individualism in party politics. The twentieth century is happily getting away from the crass *laissez-faire* and natural-rights individualism of the French Revolution. Let us beware of reintroducing into finance what we are fortunately leaving behind us in all the other domains of politics. Let us not confuse the separation of state and local revenue with the exaggerated demands of local option.

The third lesson that we have to learn is our readiness to free ourselves from our attachment to the property tax. Everywhere else in the world the general property tax has disappeared as the chief source of public revenue, and everywhere else for many decades, as I have pointed out, property is being replaced by yield or income as the base of taxation. What we are slowly doing in our corporation tax, what we are beginning to do in our forest tax and mining tax, we must get ready to do in the other parts of our general property tax. It will be a hard struggle in many of our states to bring about the constitutional changes to permit of classification of property for purposes of taxation; and yet this movement toward a classified property tax is but another way of emphasizing the point that I desire to make. For one of the reasons at least for classification, that is, levying a different rate on different classes of property, is that there is no longer any homogeneity in the yield in different kinds of property. Anything that tends to break down the reliance upon the old general property tax will be so much gained, and the sooner we get toward substituting the conception of yield or income for that of property, the closer we shall get to the practical interests of modern life. In one point alone the gain will be marked. The entire problem of franchise taxes, that is, of the tax on the franchises of corporations, will disappear for a franchise is taxable only as a piece of property, and if we replace corporate property by corporate receipts or corporate income as a test—as they have done everywhere else in the civilized world—a great number of our difficulties will vanish in thin air.

In only one point, as I have stated, must we continue to hold fast to the property idea, and that is in the matter of local taxation of real estate. But as there is no movement at the present time in this country away from the local property tax, I need not spend any time in discussing a danger that does not exist.

The fourth lesson to be drawn from present-day tendencies is connected with the distinction that I made at the outset between per-

sonal taxation and real or specific taxation. We are all agreed that the general property tax must go or, rather, that no attempt must be made to prevent its rapid disappearance. Now there are two ways of hastening its disappearance. The one method is to pursue the policy, historical, followed by other nations, namely, to convert the personal tax into a real tax, to change the general property tax on the individual into a series of taxes on the things irrespective of the individual. In this movement New York has taken the lead. As is familiar to all of you, the real estate tax has become a tax on the land and house, irrespective of the individual; the mortgage tax has become a tax on the mortgage; the secured-debt tax has become a tax on the debt; the tax on bank shares has become a tax on the bank, and so on. The immense advantage of such a movement carried to its ultimate outcome is that the administrative difficulties are reduced to a minimum and that the glaring inequalities and absurdities connected with the general property tax completely disappear. The danger, however, in the New York movement is that these steps may be considered a final solution of the problem rather than as a preparation for the ultimate solution. For, as I pointed out at the beginning, the tendency from personal to specific taxation is always ultimately replaced by a counter tendency from specific to personal taxation. In the long run you cannot silence the conviction of the average man that taxes ought to be borne by individuals in accordance with their wealth—even though you do not necessarily measure this wealth in terms of selling value of property. Accordingly, we find in one of our states, namely, Wisconsin, the second tendency referred to, *i.e.*, the effort to substitute for an unworkable a more workable personal tax, that is, in Wisconsin the old general property tax is being replaced by a new income tax. In France, you will remember, it took over a century to accomplish this result. The old general property taxes before the revolution were replaced by taxes on things, and it is only a few weeks ago that these taxes on things have been replaced by a personal income tax. The Wisconsin plan is interesting; but as I have stated in another connection, it cannot, in my opinion, solve the problem. Although income is a better test of ability to pay than property, and although the centralized administration of the income tax is an immense improvement on the local anarchy of the old personal property tax, even a state income tax cannot thoroughly succeed because of complications of interstate

taxation and the difficulty of getting at the income derived from interstate sources. Moreover, as our federal income tax develops, the confusion between the state income tax and the federal income tax levied according to entirely different principles is bound to become greater.

Thus, neither the New York system nor the Wisconsin system is in itself a solution. Each is better than the system in most of the other states; but neither is thoroughly satisfactory. The conclusion is obvious. In the one case, as in the other, an effort must be made to utilize the federal administration. Let each state add to the 1 per cent of the income tax or the corporation tax, which is a part of the income tax, as many more per cent, within reasonable bounds, as it needs for its own state purposes, and let some arrangement be made with the federal government for utilizing the federal returns. In the meantime, and as preparation for this eventuality, let those states with a less successfully organized central administration than is found in Wisconsin follow the plan of replacing their personal tax by a system of real taxes, either through a classified property tax, as is beginning in a few states, or through the system as it is being developed in New York. But do not let us delude ourselves into the belief that it will be possible or desirable by any kind of manipulation to retain indefinitely the anachronistic general property tax as it is still found in most of our states. Let us recognize the fact that New York, equally with Wisconsin, represents a step forward in the onward march of tax reform.

The final lesson to be drawn from our survey is the necessity of group or associated action among the states. In a federal form of government like that of the United States this is an imperative necessity no matter what form of taxation be adopted. It is obvious that if we have no federal control or no central fiscal legislation as is found in some of the European federal states, the complexities of double taxation will increase with the effectiveness of the tax. It is only because some of our state inheritance taxes are more successfully administered than the personal property tax that the difficulties are especially felt in the inheritance tax. But the same thing is already happening in our corporation tax and is bound to become still more important in the case of any separate state income taxes of the future. Even, however, if we have federal control or federal administration of the income tax or of the inheritance tax,

the need of some group or associated action in our states will be almost equally great; for if we should ever come to the idea sketched out above, of state additions to the federal income or to the corporation tax, there would be obvious difficulties and dangers in the way of one state making, let us say, a 1 per cent addition to the federal tax and of an adjoining state making a 5 per cent or 10 per cent addition. The risks of a transfer of business or enterprise or population from the one state to the other would be as great as at present when one state finds that unequal fiscal burdens lead to interstate migration. The practical lesson from this is that we should sedulously strive to develop the idea which is now already found in germ, the idea of coöperation between various groups of contiguous states, the idea of sectional or group associations of tax commissions such as the New England group, the central state group, etc. With this device, and with proper centralized administration, each state may be put in a position to judge of the best way to adjust its own tax system harmoniously to the interests of the whole group of states of which it forms a part. I should put this idea of interstate comity in taxation and of interstate coöperation of tax commissions at the very forefront of our present needs.

The above presentation shows how vital are the problems of fundamental importance in our present-day development. Almost every practical step that is taken by anyone in the direction of tax reform will be found to fit into one or other of the lessons that I have sought to emphasize. May our steps enable us to see each point more clearly with the lapse of time and may there emerge from this multiplicity of movements and of interests a unity that will make for fiscal justice and civic equality.